



William L. McQuillan
President
Robert N. Barsness
President-Elect
Thomas J. Sheehan
Vice President
Walter E. Daller Jr.
Treasurer
Kenneth H. Rayborn
Secretary
William D. Sones
Chairman
Kenneth A. Guenther
Executive Vice President

January 19, 1999

Honorable Jim Leach
Chairman
House Banking and Financial Services Committee
U.S. House of Representative
Washington, D.C. 20515

Dear Chairman Leach:

Last Fall, the banker leadership of the Independent Bankers Association of America (IBAA) supported full Senate consideration of the D'Amato-Sarbanes version of H.R. 10, the Financial Services Act of 1998. In taking this position, we recognized that significant strides had been made to address the concerns of not only the banking industry, but also the interests of community banks. The bill contained a number of hard-fought compromises that led to the historic, but lost, opportunity last Fall to pass legislation that was not opposed by any major sector of the financial services industry.

We applaud Chairman Leach for introducing substantially similar legislation in the new Congress, negating the unappealing prospect of re-waging old battles and re-negotiating existing compromises. We also commend Chairman Gramm for his constructive comments to move this process forward in an expeditious manner in the Senate.

Regrettably, the draft financial modernization proposal being circulated by Rep. John LaFalce (D-NY) moves in the opposite direction, is counter-productive to the process, and we must strongly oppose it.

Last Fall, the IBAA identified several guiding principles that we felt must be embodied in any financial modernization proposal. These principles included:

- Closing the unitary thrift holding company loophole.
- Providing non-discriminatory insurance language.
- Insuring even-handed consumer regulations.
- Pushing out new risky financial activities to holding company affiliates.
- Preserving the Federal Reserve as the umbrella regulator of new financial services holding companies.
- Protecting the Federal Deposit Insurance Fund.
- Providing easier access to alternative liquidity sources for community banks.
- And maintaining the separation of banking and commerce.

The version of H.R. 10 reported out of the Senate Banking Committee last Fall substantially addressed these principles, as does the bill introduced in the 106th Congress by



Chairman Leach. Unfortunately, the version being circulated by Congressman LaFalce fails this test in several important ways:

- First, it reintroduces the concept of a commercial basket by permitting a bank holding company to own a commercial firm provided the annual gross revenues from the commercial activities do not exceed 15 percent of the holding company's consolidated annual gross revenues, and the commercial assets do not exceed \$750 million at the time the commercial shares are acquired. This clearly takes this bill out of the "narrow bill" realm, and would encourage financial institutions to engage in the kind of crony capitalism that has undermined the economies of Japan, Brazil and a number of Asian nations. The case against the mixing of banking and commerce is well established. Both Federal Reserve Board Chairman Alan Greenspan and Treasury Secretary Robert Rubin have raised serious concerns about moving in this direction at this time. Moreover, the House last year voted to remove the commercial basket from H.R. 10, and this action was not overturned, or even debated, by the Senate Banking Committee. Now is not the time to open the door to commercial bank ownership of commercial firms. Chairman Leach has often and wisely pointed out that opening the door for commercial bank ownership of commercial firms will lead to demands that commercial firms be allowed to own banks -- the reserve basket. This is a path the United States should not get on.
- Second, the LaFalce draft does not close the unitary thrift holding company loophole, perpetuating the opportunity for commercial firms to own thrifts, and for thrifts to own commercial firms. This loophole is of major concern to Chairman Greenspan, and in his testimony before the Senate Banking Committee late last year, Treasury Secretary Rubin expressed his concern as well. Last year, both ABA and the IBAA made closing this loophole an absolute pre-requisite for support of any financial modernization bill. Our position has not changed. This loophole permits the breaching of the banking and commerce wall, jeopardizing the impartial allocation of credit and stretching the deposit insurance safety net beyond its intended purpose.
- Third, the LaFalce proposal does not contain Federal Home Loan Bank System reforms which IBAA believes is vital to the long-term viability of community banks. The Federal Home Loan Bank System is an important source of liquidity for community banks which face growing competition from government-subsidized lenders such as credit unions and Farm Credit associations. IBAA strongly supports the FHLBank provision in H.R. 10 that provides for automatic membership eligibility for financial institutions with \$500 million or less in assets and expands the collateral that can be pledged against advances to include agricultural and small business loans. This provision is especially important to our nation's agricultural banks to help America's farmers through the increasingly grave farm crisis.

- Fourth, the LaFalce draft contains new consumer regulations and disclosure requirements that would impose onerous new hardships on community banks, already burdened by the disproportionate cost of CRA compliance. We do not believe this new language meets the test of "even handed consumer regulations."

We urge you to not abandon the substantial progress that was made last year in the development of a financial modernization bill that addressed, in at least some degree, the concerns of all sectors of the financial services industry. As you know, the bill that came to the House floor last year was vehemently opposed by almost all sectors of the banking industry and passed the House by only one vote. This need not happen again. The LaFalce proposal re-opens old wounds, re-surfaces the differences among the banking, insurance and securities industries, and doesn't in any way address the outstanding differences between Chairman Greenspan and Secretary Rubin.

Sincerely,



Kenneth A. Guenther
Executive Vice President